

Internal Revenue Service

Number: **201702003**
Release Date: 1/13/2017
Index Number: 1362.04-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
 , ID No.

Telephone Number:

Refer Reply To:
CC:PSI:01
PLR-108592-16
Date:
September 21, 2016

Legend

X =
State =
Date 1 =
Date 2 =
A =
Trust =
a =
b =
Period =

Dear :

This letter responds to your letter dated March 10, 2016, and subsequent correspondence, submitted on behalf of X, requesting a ruling regarding X's status as an S corporation.

FACTS

According to the information submitted, X was incorporated under the laws of State on Date 1. Effective Date 2, X elected to be taxed as an S corporation. Since Date 2, A and Trust have been and currently are the only shareholders of X. X represents that Trust timely elected under § 1361(e)(3) to be an electing small business trust (ESBT). A owns a% and Trust owns b% of the stock of X.

For Period, X made disproportionate distributions to its shareholders. X learned that the distributions it made for Period were not consistent with its governing instruments and could be construed as creating a second class of stock, and thus, could potentially have terminated its S corporation election effective at the being of Period.

X represents that each share of X stock has identical rights to liquidation proceeds and distributions under its governing documents and no provisions exist in its articles of incorporation, by-laws, or other agreement that varies these rights. Neither X nor its shareholders knew that disproportionate distributions could potentially terminate X's S corporation election.

X represents that it will take remedial steps to make corrective distributions to its shareholders to eliminate the cumulative amount of the disproportionate distributions made from X to its shareholders. X further represents that the disproportionate distributions were inadvertent and X always intended to be an S corporation.

X represents that at all relevant times, X and its shareholders treated X as an S corporation and filed their tax returns accordingly. X and its shareholders agree to make any adjustments the Commissioner may require consistent with the treatment of X as an S corporation.

LAW AND ANALYSIS

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any tax year, a small business corporation for which an election under § 1362(a) is in effect for that year.

Section 1361(b)(1)(D) provides that a small business corporation cannot have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides that a corporation that has more than one class of stock does not qualify as a small business corporation. Except as provided in § 1.1361-1(l)(4)(relating to instruments, obligations, or arrangements treated as a second class of stock), a corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds. Differences in voting rights among shares of stock of a corporation are disregarded in determining whether a corporation has more than one class of stock. Thus, if all shares of stock of an S corporation have identical rights to distribution and liquidation proceeds, the corporation may have voting and nonvoting common stock, a class of stock that may vote only on certain issues, irrevocable proxy agreements, or groups of shares that differ with respect to rights to elect members of the board of directors.

Section 1.1361-1(l)(2)(i) provides that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements relating to distribution and liquidation proceeds. Although a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights, any distributions (including actual, constructive, or deemed distributions) that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances.

Section 1.1361-1(l)(3) provides that, except as provided in §§ 1.1361(b)(3), (4), and (5) (relating to restricted stock, deferred compensation plans, and straight debt), in determining whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds, all outstanding shares of stock of a corporation are taken into account.

Section 1362(a) provides, in part, that a small business corporation may elect to be an S corporation. Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation such corporation ceases to be a small business corporation.

CONCLUSION

Based solely on the representations made and the information submitted, we conclude that if the erroneous disproportionate distributions made by X to its shareholders caused X's S corporation election to terminate, the termination was inadvertent within the meaning of § 1362(f). Therefore, X will be treated as an S corporation effective the beginning of Period and thereafter, provided X's S corporation election is not otherwise terminated under § 1362(d). This ruling is contingent upon X making Remedial Distributions within 120 days of the date of this letter for Period. The shareholders of X must include their pro rata shares of the separately stated and nonseparately computed items of income or loss of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X fails to make such Remedial Distributions or X's shareholders fail to treat themselves as described above, this ruling shall be null and void.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described under any other provision of the Code, including whether X is otherwise eligible to be an S corporation. This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X and to X's representative.

Sincerely,

Laura C. Fields

Laura C. Fields

Senior Technician Reviewer, Branch 1
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this Letter

Copy for § 6110 purposes